Queen's University

Course in Banking

LESSONS VII-IX

Money and Banking

LESSON VI—*Continued.*

The banks of the New York Clearing House Association agreed that, for the purpose of enabling them to expand their loans, the specie reserves held by them should be treated as a common fund and, if necessary, should be equalized among the banks by assessments laid upon the stronger for the benefit of the weaker; and that, for the purpose of settling balances between the banks a committee should be appointed with power to issue certificates of deposit to any bank placing with them adequate security in the shape of stocks, bonds or bills receivable, and that these certificates should be received in payment by creditor banks. The effect of this agreement was that any bank which experienced an unusual demand for specie would be supported by the whole of the common stock; and that the debt to the others, which it thus incurred, could be met by a pledge of its securities. This plan, in its essential form, has been put into effect on several occasions of financial stress since, and has worked well.

The Aldrich-Vreeland Act of 1908 provided for the issue of an emergency currency along similar lines. The country was divided into districts for this purpose; and it was decided to permit banks who joined the association in each district—the district corresponding fairly well with the sphere of the clearing house in that region—to issue emergency notes based on sound approved commercial paper, up to 75 per cent. of its value. Banks could also directly deal with the Secretary of the Treasury and receive emergency notes on certain classes of municipal and corporation bonds, where such bonds were approved. In this case the note issue was based on 90 per cent. of the value of the securities. A definite limit is put on such emergency circulation, and it is subject to a tax until it has been retired. It is altogether likely, however, that the conditions under which federal reserve notes can be issued will make it unnecessary in the future to have recourse to note issues under the Aldrich-Vreeland Act.

Questions for Review.

I. *On Text.*

1. Under what conditions did Canadian banks establish redemption agencies?

2. State the arguments presented by the bankers, at the revision of the Bank Act in 1890, against fixed legal reserves.

3. What were the reasons for establishing the bank-note circulation safety fund?

4. What were the reasons advanced for ving the emergency circulation pri ilege to the banks?

5. Under what conditions was the national banking system established in the United States?

6. In what way did that system provide a market for United States bonds?

7. What were the requirements with respect to the legal reserves of national banks before the federal reserve act was passed in 1913?

8. What is meant by "seasonal demands" for bank note currency? In what way have the bond-secured notes of the national banks met that demand in the past? Show the superiority of Canadian notes in these respects.

9. What difficulties arose owing to the lack of unity in the national banking system?

10. What types of banks exist in the United States? Which issue notes? What are, in general, the functions of each?

11. Distinguish between clearing-house certificates and clearing-house loan certificates.

12. Are clearing-houses more important for checks than for notes? Why?

13. Why was the expedient of "combined reserves" resorted to by the banks belonging to the various clearing houses in the United States? Would it be of advantage to combine the reserves of New York banks regularly and permanently?

II. *On Lesson.*

14. Why have the national banks troubled themselves about combined reserves? Is there really less money in the country in time of panic?

15. State briefly the essential provisions of the Aldrich-Vreeland Act of 1908 and explain their purpose. Contrast with Canadian methods of issuing emergency circulation.

16. What are the arguments in behalf of a centralized banking system?

Questions for Written Answer.

17. Compare the Canadian and American system of banking with respect to (*a*) examination of banks; (*b*) basis of note issues; (*c*) ability to serve every part of the country. (Note: The national banking system as it existed up to 1913 should form the basis of comparison. The changes effected by the federal reserve act of 1913 will be considered in the next lesson.)

18. Why are idle banking funds attracted to New York? Does this strengthen, or injure, the banking of the United States?

19. Until the passing of the federal reserve act of 1913 the banks of the United States could not establish branches in foreign countries. What effect had that prohibition on the country's foreign trade?

20. Bring up any difficulties.

LESSON VII.

The Federal Reserve Act.

Read: *Money and Banking,* (Appendix: *The Federal Reserve Currency Act*).

Breckenridge, *The History of Banking in Canada,* Chapter 7.

The Federal Reserve Act, designed to furnish the United States with a wide discount market, and an elastic currency was passed in 1913. It provides that the country shall be divided into twelve districts; each district to have a central bank known as a federal reserve bank; the capital stock to be supplied by the national banks in the district to the extent of 6 per cent. of their capital stock. Any national bank declining to enter this system is to forfeit its charter. These district or federal reserve banks are to have the right to deal in foreign bills and to act as reserve agents for member banks. The reserves of the country banks, now held by banks in New York, Chicago and St. Louis, and other reserve cities, are to be transferred gradually in eighteen months from the date of enactment, to these new federal reserve banks.

The following table shows the districts into which the country has been divided, as well as the number of national banks in each district and their combined resources (June 30, 1914):

District.	No. of Banks.	Resources.
District 1 (Boston)	441	$ 930,170,805
District 2 (New York)	481	2,592,573,089
District 3 (Philadelphia)	756	1,245,921,250
District 4 (Cleveland)	769	1,180,491,168
District 5 (Richmond)	481	600,172,085
District 6 (Atlanta)	378	392,274,042
District 7 (Chicago)	958	1,525,953,888
District 8 (St. Louis)	457	497,799,033
District 9 (Minneapolis)	699	608,293,216
District 10 (Kansas City)	836	648,419,262
District 11 (Dallas)	740	455,177,052
District 12 (San Francisco) . . .	518	798,078,827

These figures do not include the four national banks which refused to accept the provisions of the Federal Reserve Act, nor the five banks in Hawaii and the two banks in Alaska.

The Federal Reserve Board took office in August, 1914, and proceeded to complete its own organization. The directors of each of the several reserve banks are made up of govern-

ment appointees and representatives of the member banks. Two of the government directors will be chairman and vice-chairman respectively. There will be nine directors for each federal reserve banks; and they will choose other officers, including a president, and engage whatever clerical force is necessary.

The Functions of the Board; Note Issues; Capital Stock.

The principal function of the board will be to supervise the issue of a new kind of bank note. It is to be called a government obligation, and is to be redeemable at the United States treasury and at the counter of any one of the federal reserve banks. The notes are to be issued only upon the request of a federal reserve bank, which must deposit as security therefor some of the satisfactory commercial paper which it has obtained by rediscount of the paper of member banks. A federal reserve bank must carry a 40 per cent. reserve in gold against the notes it takes out from the central board. In order to make the retirement of notes certain and rapid a federal reserve bank is not permitted to pay out the notes that have been issued by any other federal reserve bank.

With respect to note issues a careful study should be made of Sections 16-18 of the Federal Reserve Act; (appendix, *Money and Banking*). It will be seen that it is expected that the note issues of the present national banks will be gradually retired; and that the federal reserve banks will issue instead a bond-secured bank note currency which shall be obligations of the federal reserve banks procuring them. They shall be issued and redeemed under the same terms and conditions as national bank notes, except that they shall not be limited to the amount of the capital stock of the federal reserve bank issuing them. There will then be in circulation federal reserve notes, which shall be obligations of the United States, and federal reserve bank notes, which shall be obligations of the banks themselves.

The act provides that the capital stock of the federal reserve banks, if not subscribed by the national banks, may be offered for sale to the public. It also gives national banks the right to accept time drafts drawn against foreign shipments of goods, the idea being to develop in the United States a discount market similar to that found in several European countries, particularly in England.

Will New System Bring Inflation?

Will the new system give the United States what it most needs—a real national system ofbanking? The national banks certainly do not. The act which created them has made the United States a country of local banks. In the proper sense

of the word the Americans have had no national banks. The horizon of the United States banker is the community in which he lives. He knows practically nothing about the needs and resources of other communities, and is out of touch with the powerful forces which move capital from section to section and from country to country. His experience, therefore, has not fitted him to be of assistance in the drafting of a truly national system of banking, such as the country really needs. The bankers had little choice in the framing of the federal reserve act. The majority of its framers were lawyers, and they had the idea that banking can be made a safe business if it is only properly hemmed in by law. They have assumed that a federal reserve bank cannot over-issue or over-lend if it always maintains a prescribed cash reserve, and that certain smaller percentages of reserves will secure safety among national banks. But experience has proven that the amount of a bank's cash reserve is not the real test of its security. No matter what the reserve, there cannot be safety unless there is wise control, and an absolute union of power and responsibility.

There is an element of danger in the division of responsibility between the federal reserve board at Washington and the bankers of the country. There is in circulation about $600,-000,000 of lawful paper money which the banks may count as part of their cash reserves if they can get it into their vaults. All this will certainly go into the vaults of the federal reserve banks, and its place in the circulation will be taken by the new bank notes. Then the United States will be in the same position as Canada, for all the currency used in daily business, one and two dollar bills alone excepted, will be bank notes. The banks with reserves increased by $600,000,000 will be able to expand their loans and liabilities, by issuing their own notes to the extent of $2,000,000,000 without causing their reserve to fall below the legal limit. It must not be forgotten that the United States treasury is responsible for their redemption; and any serious export of gold, when the circulation of notes has been expanded to the limit, will put the treasury in a dangerous position.

Moreover, in the opinion of competent critics, including Dean Joseph French Johnson, the dividing of the country into twelve districts will mean that these sections will pull against one another, and that some of them will indulge in an over-issue of notes and in an excessive expansion of discounts.

> *Bank notes under a proper banking system can easily expand to meet the demand of the community for them; and, under a proper method of redemption, they cannot remain outstanding in excess of the needs of trade.. That is, they are properly*

elastic. On the other hand, by the very nature of the government, by the fact that it is not a bank, it is impossible that it should know how much circulation the country needs, when to increase and when to contract it. This was seen as long ago as 1790 *by Alexander Hamilton, when he said: "Among other material differences between the paper currency issued by the mere authority of the government and one issued by a bank payable in coin is this: that in the first case there is no standard to which an appeal can be made as to the quantity which will only satisfy, or that which will surcharge the circulation; in the last, that standard results from the demand. If more should be issued than is necessary, it will return upon the bank." This should be kept in mind in considering the retirement of United States government currency in favour of bank notes.*

Advantages of System.

There are, however, great compensating advantages. These are to be found in (1) the creation of a general discount market for commercial paper; (2) the systematic pooling of reserves of existing banks; and (3) the provision of an elastic currency.

Hitherto American banking has been too largely an agency in the service of speculation. This is borne out by the following considerations: (1) the interest rates controlling the flow of gold out of the United States have been dictated by the call loan market, not by those prevailing in the commercial discount market; (2) the funds which the banks desired to have ready to hand have been customarily invested in demand loans on stocks rather than in quick commercial paper or short-term foreign exchange; (3) in times of crisis or pressure the banks have shortened loans in the country instead of, as in other countries, enlarging them to accommodate legitimate borrowers. Their primary purpose, hitherto, seems to have been the upholding of the stock market, in a period of pressure.

The new act changes these conditions by (1) transferring a small but necessary fraction of the ultimate reserve of the national banks to government-inspection institutions, located in various parts of the country, where they will be responsive to, and in sympathy with, business necessities. It prescribes by rigid rules that these funds shall be applied solely to commercial needs, and to nothing else, the loans being narrowly restricted in term and character; (2) it broadens the methods of doing business allowed to national banks, so far as relates to investments in legitimate commercial paper, and narrows

them correspondingly so far as relates to investments in stocks and bonds; (3) it increases the loaning power of a bank in a given community, by permitting the issue of notes on commercial paper; and (4) it gives to each bank the support it may need by combining the reserves of all in a central institution in the same community or region. Its effort is thus to promote the growth of commercial credit and to protect that credit when brought into existence.

Creation of a Wide Discount Market.

Under the Federal Reserve Act, national banks will be able to rediscount the commercial paper of local concerns at the reserve bank in their district. This will provide the national banks with funds with which they can continue to aid local enterprises. Since it will be possible to secure funds by rediscounting commercial paper the fluctuation of interest rates from season to season should be greatly minimized. Moreover, as national banks can now procure federal reserve notes by rediscounting the commercial paper they hold, there will be no necessity of emergency measures to safeguard the country from the possible results of financial panic or stringency. Credit will be more simply available, cheaper, and more equitably open to all.

The community will not, however, gain the greatest advantage from the measure if it adheres merely to established types of operation. The new act provides for the creation of a true discount market, such as has existed for years in every European country. This means that every merchant of established local credit may in the future count upon a free sale for his paper throughout the reserve district in which he is situated, and to a somewhat lesser degree throughout the country. The rediscount principle, when fully worked out, taken in connection with the use of the acceptance system, will enable the sound, even though small, manufacturer or trader to get the advantage of the best rates of commercial paper that prevail anywhere within his region of the country. If there is capital to spare—unemployed and seeking occupation—he may expect that, through the general sale of bills under the new system, such capital will be available for the purchase of his paper, and will be so employed. By the judicious use of the acceptance the local bank will be enabled to facilitate the movement of goods into and out of the country, and will at once make the utmost of its own capital, and at the same time enable its clients to gain the widest employment for their own resources. The net results of these various influences should be: (1) considerable reduction in average rate of interest on commercial paper throughout the United States, (2) very great reductions in the rates in certain sections remote from commercial

centres; (3) stability and certainty in distribution of credit; (4) creation of new and more convenient types of paper arising through trade with foreign countries.

> *London has hitherto been the world's centre of finance. Two of the main reasons for this have been:* (1) *London has had practically the only free supply of gold in the world. No restrictions have been placed upon the flow of the yellow metal either to, or from, London. This cannot be said of the gold supplies of other European countries; and, in the past, the gold supplies of the United States have not been concentrated, owing to the decentralized banking system that has existed.* (2) *London has afforded a great discount market in the past. In the future we may expect New York to compete on more equal terms with London for the banking business of the world, not only because of the harmony of action among the banks made possible by the federal reserve act, but because of the establishment of a great discount market there.*

Reserves of National Banks.

An important feature of the new law is the economy of gold that will be effected under it. National banks will henceforth be required to keep reserves of 18, 15 and 12 per cent. against their demand deposits according as they are located in the central reserve cities (New York, Chicago and St. Louis), in reserve cities (of which there are about forty), and in the country districts, respectively. In each of these districts—whether in central reserve cities, reserve cities, or in country districts—5 per cent. must be held by way of reserve against time deposits, by the national banks themselves. The part of the reserves that national banks formerly kept with the central reserve,or reserve,banks are to be held henceforth in the federal reserve bank of the district in which the bank is situated. Time is given to bring about these changes, a period of three years from the passage of the act being granted to effect the final adjustment. As the provisions with respect to reserves are very complicated, the student should study with particular care Section 19 of the federal reserve act, (p. 579, *Money and Banking*). This means that there will be a considerable reduction in the reserves of national banks; for it will be recalled that formerly the reserve banks were obliged to hold a reserve of 25 per cent. against their demand liabilities and country banks 15 per cent. This will release a great volume of money after all new needs for the reserves of the federal reserve banks have been complied with. The effect of this provision

will be far-reaching. The United States has for many years been obliged by its antiquated banking methods to use much larger gold reserves than any other country in the world, in proportion to business done. Moreover, in times of stringency there was a scramble among the banks for gold, to build up their reserves. This tended to put a premium on the yellow metal and make interest rates high. Now that the reserves of national banks are pooled in the federal reserve banks, it ought to be possible to control, to some extent at least, the flow of gold out of or into the country by lowering or raising the discount rate. This can be done through the federal reserve board. In this way international exchanges can be effected with less cost to the community. In this particular it is expected that the federal reserve board will follow the practice of the Bank of England, which controls the supply of gold in the United Kingdom by raising or lowering its discount rate. When it raises its discount rate money becomes dearer, and gold tends to flow to England to earn higher interest rates. When the discount rate of the bank is lowered, money becomes cheap, and gold leaves the country. But this process will be more carefully explained when we consider later the functions of the Bank of tEngland, and the nature of the business i carries on.

Questions for Review.

I. *On Text.*

1. When was the Canadian Bankers' Association incorporated? What are its objects?
2. What is its jurisdiction over suspended banks? How does it supervise note circulation?
3. What are the duties of the curators of failed banks?
4. What has been the effect of competition on (*a*) banking profits, (*b*) the increase of branches?
5. When were Canadian clearing-houses organized? What are the functions of the clearing-house?
6. What are demand deposits within the meaning of the federal reserve act? (Section 19).
7. What proportion of (*a*) the demand deposits, (*b*) the time deposits, must a national bank keep by way of a legal reserve? (Section 19).
8. After three years from the passing of the act, how much of their reserves must (*a*) country banks, (*b*) reserve banks, (*c*) central reserve banks hold in their own vaults against demand liabilities? Where shall the banks in the respective districts keep the balance of their legal reserves, after the three-year period shall have been reached? (Section 19).

9. What are the provisions of the federal reserve act with respect to examination of banks? (Section 21).

10. What are the conditions under which loans may be advanced on farm lands? (Section 24).

11. Under what conditions may national banks now establish branches abroad?

12. When may the Treasury of the United States deposit government moneys with federal reserve banks?

13. What are the powers of federal reserve banks? (Section 13).

14. What are the duties of the federal reserve board? (Section 10).

15. What is the process of organization of federal reserve banks? Why are state banks and trust companies permitted to enter the system?

II. *On Lesson.*

16. Into how many districts is the United States now divided for banking purposes? What are the objects in view?

17. What is the nature of the new currency issued by federal banks? What advantages does it possess? What dangers are involved?

18. How will a new discount market be created for the United States? What advantages will it bring?

19. Will the federal reserve banks be able to regulate the flow of gold into and out of the country? How will they do so? What will be the advantages gained?

Questions requiring Written Answers.

21. What furnishes the security for the new federal reserve bank notes? How are they redeemed? Will they furnish an elastic currency to the United States? Are there any dangers of inflation?

22. Why are the legal reserves of national banks henceforth to be kept in the district in which the banks are located? Why did idle funds formerly flow to New York? What difficulties arose?

23. Will the United States henceforth have a "decentralized" banking system? What advantages will ensue from the supervision of the federal reserve board? Will the banks in the various districts likely work together? Will district compete with district, or will all work in harmony?

24. Bring up any difficulties.

LESSON VIII.

The British Financial System.

Read: Sections 489-493, chapter 29; also chapter 9 of "Money and Banking."

The Bank of England is the most famous of the great mod-public banks. While its capital has been subscribed privately it stands in such close and intimate association with the Gov-ment that it is always regarded as a public institution.

The Bankers' Bank.

The Bank of England stands at the centre of the whole financial system of the United Kingdom. It is the bankers' bank. To it the other financial institutions of the country lo… for guidance and leadership. And they have not looked in vain. As a whole the operations of this Bank have been conducted with consummate skill and the desire to serve the best interests of the nation, and not merely to make profits.

The other financial institutions of Great Britain are:

1. The joint stock banks.
2. The Scotch banks.
3. The private banks.
4. The merchant bankers and accepting houses.
5. The discount houses.
6. The postal and trustee savings banks.

These institutions, as a rule, keep large deposits with the Bank of England. In many cases they rediscount paper at this Bank and leave the proceeds on deposit as "cash." All deposits in fact, at the Bank of England are regarded as equivalent to gold, and are therefore counted in as part of the reserves of the financial institutions of the nation. It can easily be seen that this throws an enormous responsibility upon the Bank. It virtually holds the gold reserves of the whole of the United Kingdom. Moreover, as will be shown, the Bank holds practically the only free stock of gold in the world, and it is drawn upon heavily by other nations. The reserve in gold is not very large at any time, in comparison with the gold held by the Bank of France, the Imperial Bank of Russia, and the National and State banks of the United States. In a word, the British people support the greatest volume of credit in the world on the smallest reserve of gold. Their credit system is the most nicely and delicately balanced and operates with greater ease and with less friction than that of any other nation.

For many years prominent financiers have pointed out the dangers inherent in the credit structure of the United Kingdom,

and predicted disaster at the outbreak of a great war. Yet no other banking system stood the sudden shock and strain at the outbreak of the war in August, 1914, better than the banks of Great Britain. The Bank of England raised its discount rate for a short time to 10 per cent., but very soon lowered it again to 5 per cent., and business proceeded on its normal course. The government itself issued a legal tender paper currency in denominations of 10s. and £1, redeemable in gold at the Bank of England. This provided the business community with the currency it required, and in a remarkably short time business settled down to its ordinary routine course.

The Act of 1844.

While the bank's history dates back to the seventeenth century it was constituted, as we now know it, in 1844. Leading up to Peel's Act of 1844 was a controversy between the leaders of the "banking" and "currency" schools—the former maintaining that as long as paper money was redeemable on demaand in gold its volume had no effect upon prices; the latter insisting that the expansion of credit in the form of note issues increased the volume of the currency of the nation and hence tended to raise prices. The Act of 1844 was a sort of compromise between the leaders of these schools of thought. It was provided that notes could be issued by the Bank of England up to £14,000,000 on a security basis; but after that limit had been reached additional notes could be issued only on the basis of pound for pound in gold. It may be said here that the Bank's uncovered issue—that is, the issue based on securities—has slowly risen until it now stands at £18,450,000 sterling.

Although Peel's Act of 1844 is considered to have provided the fundamental law under which the bank operates, it should not be forgotten that, like all other British institutions, the Bank of England is not only regulated by statute, but by a body of customs and traditions which are no less binding than statutes, and which are of as great economic importance.

By the Act of 1844 the Bank of England was divided into two separate departments: (1) the issue department, and (2) the banking department. The issue department is concerned solely with the note issues of the Bank. It gives notes for gold or gold for notes. Of course, as has been said, the Bank has the right to issue notes on a security basis alone up to £18,450,000 sterling.

On the other hand, the real business, or at least the main business, of the bank is carried on by the banking department. Here deposits are received and loans negotiated. To all intents and purposes the two departments are separate institutions.

Note Issues of Joint Stock Banks.

From the time of the founding of the Bank in 1694 up to 1826 it enjoyed the sole right to issue notes. In 1823 it was discovered that the Bank had not been given a monopoly of banking except in its note issuing function. There followed accordingly a movement to establish joint stock banks of deposit, which resulted in certain concessions being granted by the Bank. In 1826 the Bank consented to the establishment of joint stock banks of issue at a distance of more than sixty-five miles from London. In 1833 joint stock banks were authorized in London and vicinity, but they were not given the right of note issue. In the revision of the Bank's charter in 1844 it was provided that whenever a country bank gave up its note-issuing functions the Bank of England might increase its uncovered issue by two-thirds of the amount which the country bank had had the right to issue. In this way, as has been pointed out, the bank's uncovered issue has slowly grown from £14,000,000 to £18,450,000 sterling. It was thought that the note issuing function would steadily decline in value with the growth of cheque and deposit banking; and that the country banks would not continue to regard their right of issue highly, especially as their notes, unlike those of the Bank of England, were not legal tender. As country banks have become amalgamated with London banks, or as they have opened up offices in London, they have, of course, been obliged to give up their note issues.

Distinctive Functions of the Bank of England.

The distinctive functions of the Bank of England consist of its acting as;—

(1) Banker to the British Government.

(2) Banker to the joint stock and private banks.

3. (a) Sole possessor of the right to issue notes which are legal tender in England; (b) sole possessor, among joint stock banks with an office in London, of the right to issue notes at all.

4. Provider of emergency currency.

5. Keeper of the gold reserve for British banking.

6. Keeper of the gold reserve which is most readdily available for the purpose of international banking.

These various functions fit into and supplement one another; and although it might appear that their diversity throws too much responsibility onto one institution they, in fact, enable the Bank to carry on its duties with extraordinary ease and with the least possible disturbance to the financial community. In this connection Mr. Hartley Withers, an English financial expert has said:

"By the fact that it keeps the balance of the other banks, the Bank of England is enabled to conduct the payment of the interest on the Briish debt largely by transfers in its books. By the fact that it keeps the balance of the Government and has the monopoly of the legal-tender note issue, the Bank has a great prestege in the eyes of the general public, which it communicates to the other banks which bank with it. There is an impression that the Government is always behind the Bank, and that the Bank is always behind the other banks, and this confidence has certainly done much to foster the confidence of the British public in its banking system."

The British Credit System.

A credit in the books of the Bank of England has come to be regarded as just as good as so much gold; and nearly all the other banks state their "cash in hand and at the Bank of England" as one item in their balance sheets, as if there were no difference between an actual holding of gold or legal tender and a balance at the Bank of England. From this it follows that, when an increase of currency is desirable, it can be secured by an increase in the balances of the other banks at the Bank of England, since the joint stock and other banks thus become possessed of more cash to be used as the basis of credit. Currency in England is made up chiefly of *cheques*; and expansion of currency thus consists chiefly in expansion of loans which in turn become deposits against which cheques are drawn. Since there is no legal reserve requirement in England, there is no fixed ratio between cash reserves and demand obligations. The expansion of cheque currency, therefore, is limited only by the proportion between deposits and "cash" which the banks think fit to keep. So long as they can increase their cash by increasing their credit in the Bank of England the creation of currency can proceed without let or hindrance. Their balances can be increased by borrowing from the Bank of England and leaving the loans with the Bank as deposits. The Bank of England is thus enabled to provide emergency currency with great ease, by means of loans and discounts which swell the reserves of other banks and become the basis for further loans and deposits. The elasticity of the system is thus remarkable. The merchants and bill brokers of London can, by taking approved security to the Bank of England, increase in a few minutes the basis of "cash" upon which the cheque currency of England is based.

This, of course, throws an enormous responsibility upon the Bank of England. It can be easily seen from what has been said that the gold reserves of the Bank, in last analysis, support the whole credit structure of the United Kingdom. The system is wonderfully economical and efficient; but when

it is remembered that the Bank must be looked to for the gold reserves of the United Kingdom, and that this gold is also practically the only "free" supply in the world, one can understand the enormous responsibility resting upon this great institution.

The United Kingdom has thus to a pre-eminent degree an "elastic" currency—a currency made up of metal money, bank notes, government currency notes and cheques. The greater part of its business is carried on by checking against deposits—deposits which have, in the first instance, emerged as loans or discounts. By the term "elasticity" as applied to a currency is meant the capacity to expand and contract with an increase or decrease in the demand for it—that is, the adaptation of currency supply to currency need.[1] *The English banking practice furnishes the nation with just such a currency in the enormous extent to which the cheque system has been developed.*

The International Gold Movement.

As has been seen the Bank of England keeps the balances of the other banks. Thus the latter must look to it for gold or legal tender notes at times when the local community requires such. At the end of every month, especially at the ends of the quarters or at times of national holiday, the Bank's note circulation expands on the one hand and its gold holdings fall on the other. These movements, however, are regular; and after all the extensive and growing use of the cheque reduces their importance.

Far more important is the Bank of England's duty as custodian of gold reserves used for international banking. *London is the only European centre that is always prepared to honour its drafts immediately and to any extent in gold.* Both silver and gold are a legal tender in France, and the Bank of France, therefore, can legally meet any demand upon it in either metal. Indeed, the Bank of France often charges a premium on gold, sufficient to check any demand for it. At Berlin and other European centres credit instruments are not always easily and freely convertible into gold. In the United States—at least before the passing of the Federal Reserve Currency Act—there has been no unity of action between the banks, no central institution to regulate the gold supplies of the nation. The thousands of national banks, state banks and trust companies were, at a period of crisis, too busily engaged protecting their own reserves to play any outstanding rôle in international exchange. Consequently the Bank of England has to be pre-

pared to meet demands upon it at any time from abroad. Such demands are based upon credits given to foreigners by the English banking community. The Bank must, therefore, ever remain on the alert to observe the signs of financial weather in all parts of the world. It must, if possible, regulate the price of money in London so that the exchanges may not be allowed to become or remain adverse to a dangerous point. In performing this task the Bank of England is confronted with very great difficulties inasmuch as the English banking community works independently of it. The other London banks and financial institutions accept and discount finance paper and give foreigners credits at rates which encourage further borrowing —borrowing which very often eventuates in the exportation of gold from the vaults of the Bank of England.

Now, as has been said, the proportion of cash to liabilities is wholly unregulated in English banking; and the so-called "cash" consists for the most part of deposits in the Bank of England. This system enables the other banks to multiply credits which are ultimately based on the Bank of England's reserve; and the responsibility for maintaining that reserve is left with the Bank. This it attempts to do by raising its rate of discount when necessary. If the other financial institutions follow money becomes dear in London; and this, of course, influences the rate of exchange in England's favor.

When the Bank's rate is not "effective"—that is, when the Bank can not impose its will with respect to the rate of discount upon the general money market in London—it attempts to assert itself by going into the market itself and borrowing some of the floating funds. In this way it lessens their supply and forces up the price of money. By means of this borrowing it diminishes the balances kept with it by the other banks, either directly or indirectly—directly if it borrows from them, indirectly if it borrows from their customers who hand the advance to it in the shape of a cheque on them. The "cash in the Bank of England" which the English banking community uses as part of its basis of credit is thus wiped out. Money—which in London generally means the price at which the bankers are prepared to lend for a day or for a short period to the discount houses—becomes dearer; the market rate of discount tends to advance and the foreign exchanges tend to move in favour of London. As a consequence, gold flows from abroad to the Bank of England's vaults, and the drain upon the Bank's reserve is stopped.

Why the Bank of England Borrows in the London Market.

It will be admitted that this is at best a clumsy device which the Bank is compelled to use. The Bank borrows money

that it does not want, in order to deprive the outer market of a surplus which depresses discount rates to a dangerous degree —dangerous because of its effects upon the foreign exchanges. The whole operation becomes necessary because of the lack of connection between the bank rate and the market rate. In former days the London money market never had enough money to meet its needs without help from the Bank of England. Bagehot, in his great work "Lombard Street"—published in 1873—said: "At all ordinary moments there is not money enough in Lombard Street to discount all the bills in Lombard Street, without taking some money from the Bank of England."

As long as that was true the Bank rate of discount largely controlled the market rate for money. Since then, however, the credit of Lombard Street has been so greatly extended that the general money market is largely independent of the Bank rate. There are other great banks in London—three of these giant institutions have deposits of more than $500,000,000 each —which nominally can lend at rates below that of the Bank of England. Currency in England consists largely of cheques drawn against deposits which in turn have originated as loans. There is no legal limit whatever to the extent to which these loans and discounts can be multiplied. The only limits imposed are those of publicity and the prudence with which the banks conduct their business. Hence it follows that competition between the great joint-stock banks often impels them to continue to make advances or discount bills at low rates when the Bank of England, as custodian for the English gold reserve, thinks it advisable in the interests of the foreign exchanges to impose a higher rate. This it does by borrowing some of the credit manufactured by the other banks, in order to create an artificial scarcity of money and make its own official rate effective.

In normal times the Bank of England, the Bank of France, and the Imperial Bank of Germany attempt to protect their gold reserves by raising the rate of discount. Upon the declaration of war, France and Germany suspended specie payments, while England continued to meet all obligations in gold. It should be noted that neither England, France nor Germany produces gold; yet — aside from war conditions — none of the banks has any trouble in procuring and maintaining a sufficient gold reserve. The Bank of England, for instance, has an unwritten rule that the minimum of its reserve against liabilities shall be in the neighborhood of 40 per cent. By a conservative reduction of loans the Bank increases the percentage of reserves to liabilities; and the void left by the loans

recalled is filled by foreign capital. The transfer of such foreign capital to England occasions a fall in the foreign exchanges, and such a fall checks the outflow of gold and in the end replaces it by gold importations.

Bank of England Statement.

The following figures show the condition of the Bank of England as on November 1, 1914:

ISSUE DEPARTMENT.

Liabilities.	£	*Assets.*	£
Notes issued	87,128,055	Government debt	11,015,100
		Other securities	7,434,900
		Gold coin and bullion....	68,678,055
	87,128,055		87,128,055

BANKING DEPARTMENT.

	£		£
Proprietors' capital	14,553,000	Government securities . .	17,004,067
Rest	3,203,460	Other securities	105,091,369
Public deposits	19,249,493	Notes	51,609,025
Other deposits	13[illegible]71	Gold and Silver coin	602,868
Seven-day and other bills	14,725		
	174,307,349		174,307,349

A note of explanation may be given here regarding some of the items on the above statement. "Public deposits" include exchequer, savings banks, commissioners of national debt, and dividend accounts. "Other deposits" comprise individual deposits of banks. "Seven-day bills" are post-notes still issued to a small amount. "Government debt" is the loan made by the Bank to the government in consideration of securing its charter. "Other securities" include loans and advances to customers upon security. "Rest" means the surplus profits on hand—called "reserves" by Canadian banks and "surplus" by the national banks of the United States.

As has been said already the real business of the Bank is carried on in the banking department. The issue department merely regulates the issuing of notes—giving notes for gold or redeeming notes in gold. It will be recalled that up to £18,-450,000, notes may be issued on securities alone. It is obvious that the notes held by the banking department are an asset, not a liability, as they represent claims against the issue department.

The only limit to the amount of notes that may be issued at the demand of customers is the gold supplies of the Bank. Now, at times of crisis, the Bank is placed in a serious position,

as it holds the gold reserves of the United Kingdom and also the only free supply of gold for international needs. Obviously as these demands deplete its gold reserves its ability to issue notes to customers is seriously curtailed. As its notes are a legal tender in England and Wales there is a great demand for them in periods of emergency. On three occasions, therefore, it has been found necessary to disregard that provision which limits the amount of notes that can be issued on securities alone; and, further, more than once this extreme measure has been escaped with difficulty.

On the occasions when the limiting clause of the act of 1844 was suspended it was done so with the consent of the government, and later an act was passed by parliament relieving the Bank of any penalty it had incurred for disregarding the provisions of the act. This was done because, as has been explained, although the Bank of England is not a government institution, it stands in very close relationship with the government and the financial life of the nation. On the occasions when the limiting clause, dealing with the conditions of note issue, was disregarded, the banking department merely presented additional securities to the issue department, instead of gold, for additional notes. When customers were assured they could get all the notes they required on depositing proper collateral the panic passed away. A panic is, in great part, psychological in nature. When business men found they could get all the notes they required the demands upon the Bank diminished; for it should be remembered that the notes are legal tender in England as well as the actual gold. Thus it will be seen that the Bank of England not only furnishes in normal times an asset currency to the country by means of the accommodation it grants to other banks in the way of loans which become in turn the bases for further loans, by means of which deposits are built up against which cheques may be drawn, but it also furnishes in times of great stress an abundant supply of legal tender money in the shape of its own notes.

The Joint Stock Banks.

The most obvious function of the joint stock banks of England is the receiving of money from customers, the granting of loans, and meeting cheques drawn against balances. Customers place money with them either on current or deposit account. On current account it can be withdrawn at any time and earns, as a rule, no interest. Many banks, indeed, make a charge for keeping money on current account unless £100 as a minimum is deposited. Sums left on deposit are usually for a week or longer; and the rate paid on them, if placed for a week, is generally 1½ per cent. below Bank rate.

The currency used in England consists of coins, notes and cheques. The coins are minted by the government, gold coin being legal tender to any extent, silver up to £2, copper up to 1s. The silver and copper coins are mere tokens, passing at a conventional value which is far above that of the value of the metal contained in them. The use of this metallic currency is almost entirely confined to the poorer classes which can not afford the luxury of a banking account. After the outbreak of war government notes in denominations of £1 and 10s. were put in circulation; but this paper currency is also largely used by the poorer classes.

The cheque has largely displaced the use of the bank note among the business classes. This explains why the joint stock bank-note currency is declining in volume in England. Notes of the Bank of England are extensively used by the other banks as reserves, and for till money. No legal reserve is required; and, as has been said, the joint stock banks regard their balances at the Bank of England, on which their loans to a large extent are based, as equivalent to so much "cash." Thus the English abnking system works with extreme elasticity, and banking facilities can be provided with extraordinary ease.

The English Cheque System.

Something should be said of the form of cheques which the English banks provide to their customers as currency.

Legally a cheque is a bill of exchange drawn on a bank and payable on demand. The form, however, can be varied in different ways, increasing or diminishing the ease with which the cheque can be turned into cash. The cheque can be made payable to A. B. or bearer, and can thus be turned immediately into cash. When drawn to A. B. or order a cheque has to be endorsed on the back by A. B. before the bank drawn on will pay it. A still further restriction is the English system of crossing cheques: that is to say, of drawing two lines across the face of the cheque, by which mark it is shown that the cheque is not to be paid in cash across the counter by the bank drawn on, but must be paid into a bank by the payee, and so only becomes credited to him in his own banking account through the operations of the clearing house. It is obvious that this system greatly increases the safety of the cheque.

Branch Banks in England.

A remarkable development of English joint stock banking is the rapidity with which they have covered England with branch establishments. This multiplication of branch offices has been carried out partly by the absorption of the smaller institutions of the country, whether private or joint stock, and

partly by the rapidity with which they have opened up branches in the great provincial cities and their suburbs, and to a moderate extent in the small country towns. This rapid development of branch banking has increased competition between the banks perhaps to an excessive degree; but it has brought banking facilities and accommodation to all parts of the nation.

The Private Banks.

Any differences that exist between the private and joint stock banks of England lie in their ownership rather than in their functions. Their functions are the same; but the manner in which they carry them out is influenced to a slight extent by the fact that the private banks are owned by a few partners who generally conduct the business themselves, or exert more or less influence upon it, while the joint stock banks are managed by salaried directors and officials on behalf of a large body of shareholders formed into a public company, the shares in which are bought and sold on the London Stock Exchange. The private banks are now few in number, having been absorbed for the most part by joint stock banks or reorganized as such.

The Merchant Bankers and Accepting Houses.

The most important function of the merchant bankers is not that of banking, but of accepting. In the strict sense of the word they do not engage in banking at all. Their function is that of bringing into being those important credit instruments known as bills of exchange. A bill of exchange, originally drawn on a merchant by a correspondent, from whom he has bought goods, directing him to pay the consideration for them at sight or at date named, has become, by process of evolution, an instrument by which credit can be raised against any form of security or collateral, or in some instances against no security at all but the credit of the parties named upon it.

The business of acceptance has thus grown up as an important and separate function which is largely in the hands of the lenders among the old merchant firms, whose acceptance of a bill stamps it at once as a readily negotiable instrument. A bill of exchange drawn against an English buyer of Canadian or American wheat might not find a ready sale in the discount market in London. But if it is drawn against a well-known merchant banker his signature at once makes the bill a first-class security for investment purposes. Hence, the English purchaser of wheat or any other commodity generally arranges with an acceptance house to accept a bill of exchange drawn upon it; the purchaser guaranteeing to put the accept-

ance house in funds to meet the bill when it is due. The exporter in the United States, let us say, can at once get his money by discounting the bill at his own bank; the American banker can in turn, after having had the bill accepted in London, sell it in the discount market; the English buyer can get his wheat, sell it, and meet his obligation at the acceptance house when it is due. This is but typical of a host of bills that may come into being in a similar way, and which find a ready sale because of the names of well-known bankers being found thereon.

The London banks, however, control the situation in last analysis, for they may discriminate against the paper of any merchant banker who has been accepting bills too freely. It should be observed, also, that the London acceptance houses conduct the same kind of business for continental, as well as for English, dealers. At the outbreak of war in August, 1914, they had become responsible for millions of pounds sterling arising from bills of exchange which they had accepted for German importers. The war prevented German dealers from meeting these obligations as they became due; and this explains in large measure why it was necessary to declare a moratorium in England. The discount houses were given time to secure the funds necessary to meet their maturing obligations on German account.

The Scotch Banks.

The functions performed by the Scotch banks are essentially similar to those undertaken by the joint stock banks of England. The differences between the currency systems of the two countries are in degree rather than essence.

The growth of note circulation north of the Tweed has been slow, while in England note issues among the joint stock banks are nearing the vanishing point. In Scotland notes may be issued in denominations of £1 and upwards, whereas in England the smallest note is for £5. (This, of course, applies to the banks. As has been said, the government is now issuing a paper currency made up of £1 and 10s. notes.) It is thus seen the bank note circulates among all classes in Scotland; and so has gained and retained a hold upon a wide circle in the community. In this respect, as in others, Scotch banking is more democratic than English, and provides its facilities for a poorer class in the community.

Especially in their early days Scotch banks encouraged the small tradesman and farmer and granted accommodation against security, or an absence of security, which would have been regarded as feasible in England only under quite exceptional circumstances. The system known as "cash credits"

has been largely used in Scotland, by which borrowers go to banks and get accommodation against the joint personal security of themselves and one, or two, or three friends. Thus very poor borrowers were able to gain loans; and many frugal, thrifty and enterprising men were able from humble beginnings to build up large and important interests.

The banks of Scotland have a further advantage over those in England in their system of note issue. By Peel's Act their total "uncovered" circulation was fixed at £3,087,000, which has since been reduced by the failure of two banks to £2,676,000. Bank notes up to that limit may be issued on securities alone; every note beyond that sum must be based pound for pound on gold. Now the Scotch banks hold a certain amount of gold as a reserve against their deposits; and they have chosen to regard it also as a basis for note issues. There is nothing in the act to prevent their doing so. Now, as a bank note does not become an obligation until it is issued, the Scotch banks make a very great saving on the "cash" used as till money, by holding their own notes instead of gold. It has been estimated by competent authorities that the banks of Scotland thus economize to the extent of at least £10,000,000 on the gold that they otherwise would be compelled to hold. That is to say, they save the interest on this vast sum of money which would otherwise be lying idle in the shape of gold in their vaults. In England, on the contrary, where the joint stock banks make little use of their own notes, they must hold as till money large sums in gold or Bank of England notes to meet the requirements of business.

As has been said, the law is silent concerning the cash that should be held against deposits. The gold reserves held against deposits, in the Scottish banks, are probably extremely slender, if the cash held against notes is set on one side. But it is impossible to detect its actual amount since the Scotch banks include with their cash their balances at the Bank of England—balances, be it remembered, that may have resulted in loans from the Bank. And the net result is, that when the proportion of their cash to their total liabilities on notes and deposits is worked out it is found to be low, even when compared with English practice. The Scotch banks—with one exception—do not follow the example of English provincial banks in including in their cash on hand loans at call or short notice.

The Scotch banks, it may be said in conclusion, have avoided the excessive competition which is a characteristic of English banking. Indeed, in Scotland co-operation among the banks is carried to an extreme of which the mercantile community frequently complains. The banks are few in number, there being eight only. They stand together like a close corporation; they agree among themselves as to the rates they

will allow to depositors; the rates at which they will make advances or discounts; and the terms and commissions for which they will do business for customers. Yet they are wonderfully economical and efficient in operation; and by their system of "cash credits," and the liberal aid they have given to every sort of industry, have done much to place Scotland among the most prosperous nations of the world.

Questions for Review.

I. *On Text.*

1. What is the relation between foreign and domestic exchange?

2. What is the relation of credit balances to international exchange?

3. What are the functions of the bank in making payments on international exchange?

4. What determines the cost of currency shipments?

5. Why are bankers willing to purchase foreign drafts?

6. Trace the progress of a bill of exchange, covering the sripment of wheat from the United States to England, from the time it is drawn until it is paid.

7. What determines the minimum and maximum gold points in foreign exchange?

8. What is the relation of foreign commerce to international exchange?

9. What are the 'invisible items" of foreign trade?

10. Name and classify the chief varieties of foreign exchange.

11. What is meant, precisely, by "finance bills"?

12. What are commercial letters of credit, and how do they originate?

13. Describe the main provisions of the Bank Act of 1844.

14. What is the relation of the Bank of England to the government of the United Kingdom?

II. *On Lesson.*

15. How does the Bank of England provide the country with an elastic currency?

16. What is the nature of the work performed by the merchant acceptance houses?

17. To what extent is branch banking developed in England and Scotland?

18. In what sense may it be said that the Bank of England has the only "free stock" of gold in the world?

19. Describe the British credit system.

19. Why does the Bank of England borrow in the London money market?

20. Describe the meaning of the various items in a Bank of England statement.

21. What are the functions of the English joint stock banks?

22. What is the difference between the private banks and the joint stock banks of England?

Questions for Written Answer.

23. Describe the main features of the Scotch banking system.

24. (*a*) How does the Bank of England provide additional currency in times of crisis? (*b*) Should the other banks regard their balances with the Bank of England as equivalent to "cash"?

25. What are the measures adopted by the Bank of England to protect its gold reserves?

26. Bring up any difficulties.

LESSON IX.

The Bank of France; The Imperial Bank of Germany.

Read: Money and Banking, Chapter 29, Sections 494-502; Chapters 28 and 29.

The Bank of France is a bank of the simplest type—a type wherein a bank is authorized to practice discount, deposit, and the issue of notes without any special provision for the safety of one class of liabilities over another. Among existing banks, the Bank of France is a remarkable instance of this free organization of banking, surviving, prospering and enjoying the merited confidence of the French people, long after the public opinion of other leading countries required special and elaborate provision for the safety of all bank debts which take the form of notes.

The Bank of France Established, 1800.

The Bank of France was established in Paris in 1800, with the encouragement of the government and even with Napoleon as one of its stockholders. There were other banks in existence in France at that time, all having the right to issue notes. In 1803, however, Napoleon announced a complete change of policy. The Bank of France was given the exclusive right to issue notes in Paris until 1818, and its capital was fixed at 45,000,000 francs,—$9,000,000 in Canadian money. Banks of issue could be established outside of Paris with the consent of the government, but none were formed until aftr the Restoration. All other issues of notes were at once withdrawn. One of the rival banks in Paris was absorbed by the Bank of France, and another acted merely as an intermediary between the bank and its customers. With the existing habits of business, credit in the form of notes was so strongly preferred that the monopoly of note issue gave the Bank a commanding position in French finance which has lasted to the present day.

The Bank of France and the Government.

Although the Bank still chose its own officers and enjoyed a nominal independence, it was now becoming involved in the operations of the French treasury. It passed through a crisis in 1805, which resulted in connecting it more closely with the government. In the spring of 1806 a measure was adopted which definitely settled the character of the Bank as a public institution, but did not alter the essential principles of its organization. By the doubling of its capital and the extension of its privileges to 1843, not only its pre-eminence in the finan-

cial affairs of France, but its position in European finance was assured. In 1840 its privileges were extended to 1867; in 1857 to 1897; and in 1897 to the end of 1920. Since 1848 it has enjoyed a complete monopoly of the right to issue notes. Owing to the comparatively slight development of deposit banking in France until recent times it has had the largest share of the banking business of the country.

The relation of the Bank to the government is such that it may be regarded as a state institution, notwithstanding the fact that its capital is owned by private individuals. The ministry appoints its governor and two sub-governors; and the legislature is enabled completely to review its affairs on the occasions that it asks for a renewal of its charter, and at other times, if it is desired. The fact that its capital is invested chiefly in public securities, and that it serves as the financial agent of the government, has given it a large interest in public affairs and made its good management and safety matters of great importance to the State. It is, however, comparatively free from legislative, as distinct from governmental, regulations pertaining to the details of its business. The government has on many occasions used the Bank for its own ends. Napoleon made it an engine of the State. Under him it was a private organization merely with respect to the ownership of its property, but a public institution so far as the actual employment of that property was concerned. Successive governments have used the Bank in different ways as the case has seemed to require; but such as Napoleon made the Bank in 1806 it has remained ever since—an institution subject to the control, and often available for the needs, of the government of the day.

History of Growth of Bank of France.

The revolution of 1848 found in existence the Bank of France with fifteen branches and also nine independent banks of issue. No system of redemption at a common centre had been adopted by the latter; even the branches of the Bank of France redeemed each other's notes only at pleasure. France had, in a word, a system of local banks whose notes had only a local credit. For this and other reasons the provisional government in the spring of 1848 made all the independent banks branches of the Bank of France. Their shareholders, in exchange for their old stock, received shares in the Bank, and the capital of that institution was increased to 91,250,000 francs. By subsequent legislation many branches and agencies of the Bank have been established in all parts of France.

The branches so established, however, have not adequately filled the functions of local banks. Each branch has its capital

allotted to it by the Bank, and is then required to carry on its business strictly under the supervision of the latter. It does not engage in any operation with the other branches except by special permission. Its business, even to the rate of discount, is directed by a policy settled at Paris, and not with reference to local wants. Its board of directors is selected by the governor of the Bank from a list of candidates made up, in some cases, at Paris, and in some by local stockholders where the latter represent half of the capital allotted to the new branch. The real authority is in the hands of a manager appointed by the government who is assisted by subordinates sent from the capital. That one half of the discounts of commercial paper is made by the branches, however, seems to show that they are performing services of great value to the nation.

On more than one occasion the government found, after 1814, that the Bank could not effectively serve the business of the country and was forced to bring state capital to the aid of private business. This was notably the case after the revolution of 1848. By a combination of private capital with public, discount houses were established in Paris and the departments. Their organization and powers made them strongly resemble independent banks, having the state as a shareholder. Many of these offices continued to transact business for several years after the revival of affairs under the Second Empire. Some of them were finally reorganized as banks of discount, repaying to the State its share of the original capital. One of these became the Comptoir d'Escompte of Paris, with a capital of 80,000,000 francs, and prospered for many years. It failed disastrously in 1889, upon the collapse of the great copper syndicate, but was reorganized under its present name, the National Comptoir d'Escompte de Paris. The number of independent banks of discount in France has greatly increased, not merely in the great cities but in the provincial towns. In addition, as has been pointed out, the Bank of France itself has branches in every department. The Bank requires three signatures upon all paper discounted by it, unless accompanied by certain specified collateral. This necessarily, in some cases, brings in a third party between the borrower and the Bank. However, the other banks of discount are able to meet the commercial needs of the community. They would doubtless have grown up sooner in France but for the monopoly given to the Bank in 1848 with respect to the right to issue notes. This is the form of credit most needed in remote districts. The use of cheques drawn against deposits grew more slowly in France, too, than in the United Kingdom and the United States. This explains in part the need for state aid in establishing banks of discount.

The Bank is now in much closer relationship with the small tradesman, too, than in its earlier history. It is true that tradesmen's paper for small sums reaches its bill case largely through its rediscount by other banks; but the fact remains that the Bank advances money on paper which stands for very small sums indeed—much of it for 100 francs or under. The proportion of small paper discounted has risen steadily in recent years.

The Bank of France During the War of 1870.

It is not possible to follow the fortunes of the Bank during the kaleidoscopic political changes in France up to 1870, but the conduct of its affairs at this period merits special attention. Three weeks before the outbreak of hostilities it had a reserve of cash almost equal to its notes, and amounting to nearly two-thirds of all its cash liabilities. The approach of war caused a heavy pressure upon the bank for loans. Both notes and specie were drawn from it in large amounts, and either hoarded or sent abroad. Very soon the government suspended the collection of commercial obligations, and the suspension of specie payments by the Bank followed. On the 12th of August, 1870, four weeks from the declaration of war, the Bank was authorized, then, to refuse payment of its notes in specie. For the second time in its history the notes of the Bank were made a legal tender for all debts, public and private. On August 13 was passed the first of the measures which postponed all commercial debts for one month, and then, by successive extensions of time, until July, 1871, without other burden to the debtor than liability for interest until the final payment. And finally, on August 14, the limit of note issue by the Bank was raised to 2,400,000,000 francs. This completed the series of measures under the authority of which the Bank was administered during the war.

The State obtained several advances from the Bank during the course of the struggle. During the siege of Paris the branch at Tours became the agency by which considerable advances were made to the provisional government at Tours, while the Bank continued to aid the government in Paris. After war with Germany ended the Bank found itself in a serious position because of the demands of the Commune—the revolutionary government in Paris—upon it. After the suppression of the Commune the Bank once more came to the aid of the government, which received from it, from first to last, (up to July, 1871), 1,425,000,000 francs. Its notes had been increased by 800,000,000 francs above the highest point ever reached before. But its affairs were managed with such brilliance that there was but a slight depreciation of the paper.

The government was not able at once, however, to repay its loans to the Banknk, so that the latter might resume specie payments. France had to face the problem of paying to Germany, in the next few years, the great indemnity of five thousand millions of francs.

In these circumstances the Bank found its first duty in extending aid to the trade and commerce of the nation; for it was in the production of wealth that France had to find the means of escape from the economic misery caused by the war. The Bank, therefore, for the moment did not attempt to resume specie payments, but bent all its energies towards reviving the production and exchange of goods. It rapidly enlarged its discounts and advances to individuals; and, as the cheque system had not been as yet highly developed in France, its loans were largely made in the form of notes. To this end, July, 1872, the government raised the limit of note issue to 3,200,000,000 francs, and permitted the Bank to issue notes as low as 5 francs.

Thus, while the government was borrowing in all the markets of Europe, including that of Germany itself, to raise funds to discharge the indemnity the Bank looked after the commercial interests of the nation. Although the government reduced to one per cent. the interest on its own debt due the Bank, the latter made great profits during these years—dividends of 20 per cent. being paid for the second half of 1871, 32 per cent. for 1872, and 35 per cent. for 1873.

In 1871 the government began to repay its debt to the Bank at the rate of 200,000,000 francs per year. The payment of the indemnity to Germany was completed in August, 1873; and in 1874 the Bank prepared to resume specie payments. It reduced its discounts and accumulated specie, at the same time withdrawing a large part of its circulation. Notes of 25 francs and less were withdrawn from circulation, and specie allowed to take their place in the hands of the people. The specie (gold and silver) in the Bank reached its highest point in June, 1877, when it stood at 2,281,000,000 francs, the Bank having accumulated over 1,500,000,000 francs in three years. Of this amount about 60 per cent. was in gold; it being the policy of the Bank to hold much gold to meet the demands of foreign trade and also to safeguard itself against a rapid decline in the value of silver. Specie payments were resumed January 1, 1878. The notes continued to be a legal tender for all debts, as they are to-day. The final instalment of the government debt was paid the Bank March 4, 1879.

Reserves of Bank of France.

Sufficient has been said, perhaps, of the history of the Bank to show how it was established and why it became the

dominant financial institution of France. It is not necessary, therefore, to follow in detail the further career of the Bank; rather it will be necessary to analyse the powers and functions which it has gradually developed. To follow the discussion intelligently the financial condition of the Bank should be considered. The following statement shows the condition of the Bank at the outbreak of war and a year before that date. (The figures are in pounds sterling.)

	July 30, 1914	July 31, 1913
Assets.	£	£
Coin and bullion—gold	165,654,000	134,489,000
Coin and bullion—silver	25,018,000	25,095,000
Government securities	15,704,000	15,704,000
Discounts and advances	128,119,000	102,926,000
Liabilities.		
Notes	267,327,000	227,073,000
Government deposits	15,303,000	15,524,000
Private deposits	37,903,000	26,287,000

A striking feature of this statement is the immense metal reserves of the Bank of France. And yet the Bank is not, as might be supposed, directly or personally interested in possession of enormous specie holdings. The note issues based on these cash reserves do not represent clear profits; far from it. A dead loss is incurred in the holding of idle gold; and in increasing its gold reserves the Bank is working against the interests of its shareholders. In other words, the circulation which alone can yield a profit has nothing to gain from the increase in the circulation which is covered by a metallic reserve. If smaller reserves were held the Bank could, at times, charge higher discount rates, and might even be compelled to do so to protect its gold supply. If the note issue covered by gold were reduced its profit-yielding circulation would not be decreased, and it would be relieved of very heavy stamp duties, of the expense of manufacturing notes it would not be called upon to issue, and of the charges for safekeeping the corresponding amount of metallic currency.

But from 1870 up to the present time the holdings of the Bank of France have not ceased to grow, not because of its own volition but in great measure to forces beyond its control. The exchanges are usually in favor of France owing to the interest payments made yearly on the enormous sums that country has invested abroad, and to the extent of its exports. This for many years has resulted in the continual flowing of the precious metal into the vaults of the Bank of France.

(*Continued in next Bulletin*).

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